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No. 84-498

In the Supreme Court of the United States

OCTOBER TERM, 1984

UNITED STATES OF AMERICA, PETITIONER

v.

NATIONAL BANK OF COMMERCE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY MEMORANDUM FOR THE UNITED STATES

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TABLE OF AUTHORITIES

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1. In our petition (at 15-16), we showed that the decision below conflicts with decisions of the Second, Fifth, and Ninth Circuits, each of which has held that a taxpayer's unrestricted right under state law to withdraw funds from a bank account constitutes "property [or] rights to property" within the meaning of Section 6331 of the Internal Revenue Code.[1] Those courts reasoned, in direct conflict with the Eighth Circuit here, that a depositor's right of withdrawal is a "right to property" on which the IRS may levy, regardless of the fact that there may exist other, competing claims to the funds on deposit and that the question of ultimate ownership may thus be unresolved.

Respondent makes no serious effort to disprove the existence of a circuit conflict on this question. It notes (Br. in Opp. 9-10), as we noted in our petition (at 16 n.10), that

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[1]Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

most of the decisions we cite involved situations in which the potentially competing claim to the funds on deposit was the bank's unexercised right of set-off, rather than (as here) a co-depositor's unexercised right of withdrawal. This factual difference, however, is irrelevant to the legal question we ask the Court to review. That question is whether a delinquent taxpayer's rights vis-a-vis the bank under state law — *i.e.*, his unrestricted right to draw down the full outstanding balance in the account — constitutes "property [or] rights to property" within the meaning of Section 6331. The cited decisions and the decision below are in direct conflict on this question, although the question has arisen in factual contexts that involve immaterial differences in the identities of the potentially competing claimants and the nature of their claims.

2. In our petition (at 19-23), we contended that this case presents a question of considerable importance to the federal system of tax collection and hence would merit this Court's review even absent a circuit conflict. Practically speaking, we noted, the decision below will make IRS administrative levies impossible whenever a taxpayer's property is titled in joint names — a staggering result when one considers that the IRS serves levies on several hundred thousand joint bank accounts (not to mention other forms of jointly-held property) every year. The IRS would be forced by the decision below to go to court whenever it seeks to collect delinquent taxes from jointly-owned property, effectively depriving the Commissioner of the nonjudicial remedy that Congress provided by enacting the administrative levy provisions of the Code, while at the same time imposing an incalculable burden of litigation on the government and the federal district courts. Respondent does not dispute — indeed, does not even address — any of these considerations.

3. Respondent concedes (Br. in Opp. 12) that "Roy possessed the unqualified right to withdraw the full amount on deposit in the joint checking and savings accounts, without notice to his co-depositors, for his own exclusive benefit," and that the bank for its part "was obligated to honor any withdrawal requests Roy might make, again up to the full value of the accounts." Respondent asserts, however, that "Roy would have these rights only under Arkansas *banking* law, and not under Arkansas *property* law" (*id.* at 13 (emphasis in original)). In speaking of "Arkansas property law," respondent evidently means Arkansas garnishment law (see *id.* at 2-3, 15), under which a co-depositor's right to withdraw the funds in a joint bank account "is not a right which can be exercised by a creditor of one of the depositors" (*id.* at 15). Rather, a creditor in an Arkansas garnishment proceeding must file a state-court action joining all co-depositors and permit the latter to show "by parole or otherwise the extent of [their] interest in the account" (*ibid.* (original quotation marks omitted)). From this premise, respondent concludes that Roy's right to make unrestricted withdrawals is not a "right to property" within the meaning of Section 6331.

As noted in our petition (at 13-14), this argument, which also underpinned the decision below, reflects a serious misunderstanding of the role properly played by state law in resolving federal tax questions of the sort involved here. This Court has repeatedly held that state law is relevant only in "determining the *nature of the legal interest* which the taxpayer ha[s] in the property * * * sought to be reached" by the federal taxing statute. *Aquilino* v. *United States*, 363 U.S. 509, 513 (1960) (emphasis added). Once the nature of the taxpayer's legal interest is defined, the question whether that interest constitutes "property [or] rights to property," as those terms are used in Section 6331(a), is a question of federal law. *United States* v. *Citizens & Southern National Bank*, 538 F.2d 1101, 1105 (5th Cir. 1976), cert. denied, 430 U.S. 945 (1977).

That was the basis of this Court's decision in *United States* v. *Bess*, 357 U.S. 51, 56 (1958), where it was held that a delinquent taxpayer's interest in the cash surrender value of a life insurance policy is "property [or] rights to property" to which a federal tax lien may attach.[2] The dispositive fact in the Court's view was that the taxpayer had "the right under the policy contract to compel the insurer to pay him this sum" and thus possessed "a chose in action * * * which he could have collected from the insurance companies in accordance with the terms of the policies" (*id.* at 56 (original quotation marks omitted)). The Court deemed it irrelevant that "under state law the insured's property right represented by the cash surrender value [was] not subject to creditors' liens," reasoning that, "once it has been determined that state law creates sufficient interests in the [taxpayer] to satisfy the requirements of [the Internal Revenue Code], state law is inoperative" (*id.* at 56-57).

Here, as in *Bess*, Roy had the right under state law and his contract with the bank to compel it to pay him the full outstanding balance in the joint checking and savings accounts, and he thus possessed a chose in action which he could have collected from the bank in accordance with the terms of those accounts. That right belonging to Roy is a "right to property" within the meaning of Section 6331. It is irrelevant under *Bess* that Roy's creditors in an Arkansas garnishment proceeding could not have exercised his right of withdrawal in their favor. As a matter of federal law, the IRS in an administrative levy proceeding "steps into the taxpayer's shoes" and acquires whatever rights the taxpayer himself possesses. See *United States* v. *Rodgers*, No.

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[2]As noted in our petition (at 6-7), the formula set forth in the Code for attachment of federal tax liens (I.R.C. § 6321) and for exercise of the Commissioner's power of administrative levy (I.R.C. § 6331(a)) is the same. In each case, the IRS may reach "all property and rights to property * * * belonging to" the delinquent taxpayer.

81-1476 (May 31, 1983), slip op. 12 n.16 (quoting 4 B. Bittker, *Federal Taxation of Income, Estates and Gifts* para. 111.5.4, at 111-102 (1981)). Since Roy possessed the unqualified right to withdraw the outstanding balance and use it to pay his taxes, the IRS sought, by virtue of the levy, to do on his behalf only what he could have done of his own volition. Roy's right of withdrawal was thus a "right to property" on which the IRS could levy and Arkansas garnishment law "is inoperative" (*Bess*, 357 U.S. at 57) to alter that outcome.

4. Respondent contends that, even if Roy's right of withdrawal constituted a "right to property," it would still not be required to honor the levy because "such a right is only in [Roy's] possession and not in possession of the [bank]" (Br. in Opp. 14). On respondent's view, "[t]he levy of the IRS reaches only property or rights in possession of the person upon which the levy is served" (*id.* at 14-15). Since it "is not in possession of this right to withdraw," the bank says, "it holds nothing to be levied upon" (*ibid.*).

This argument is frivolous. Section 6332(a) provides, with exceptions not relevant here, that "any person in possession of (*or obligated with respect to*) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary, surrender such property or rights (*or discharge such obligation*) to the Secretary" (emphasis added). Respondent was obviously "obligated with respect to" Roy's rights to property because, as it concedes (Br. in Opp. 12), it "was obligated to honor any withdrawal requests Roy might make." If respondent's view were correct, the IRS would be precluded from serving notices of levy upon banks with respect to depositors' accounts under any circumstances. But levies on bank accounts have been permitted since 1924, and the Treasury Regulations explicitly authorize the IRS to serve notices of levy "on any person in possession of, or obligated with respect to, property or rights to property * * * including

* * * bank accounts." Treas. Reg. § 301.6331-1(a)(1). Indeed, as noted in our petition (at 19 n.13), the IRS serves about 500,000 notices of levy on banks annually.

5. Respondent errs in seeking support for its position from this Court's decision in *United States* v. *Rodgers*, No. 81-1476 (May 31, 1983). That case involved the interpretation of Section 7403(a), which authorizes the IRS to bring a plenary judicial action to foreclose its tax lien and subject "any property * * * of the delinquent, or in which he has any right, title, or interest, to the payment of [the] tax." The question in *Rodgers* was whether Section 7403 empowers a district court to order the sale of a family home in which the delinquent taxpayer has an interest, but in which the taxpayer's nondelinquent spouse also has a homestead interest under state law. This Court held that sale of the entire property, and not merely of the delinquent taxpayer's interest in the property, is permitted, provided that the nondelinquent spouse is compensated out of the sale proceeds for his or her homestead interest in full. Slip op. 12, 19-21.

In reaching that result, the Court compared Section 7403's operation with that of Section 6331, which permits the IRS to levy on "property and rights to property * * * belonging to" the delinquent taxpayer. The Court noted that "Section 6331, unlike § 7403, does not require notice and hearing for third parties, because no rights of third parties are intended to be implicated by § 6331" (slip op. 17). The Court observed that "third parties whose property or interests in property have been seized inadvertently" by IRS levy may apply for return of that property either through administrative channels or through a wrongful levy action in federal district court. Slip op. 17, citing I.R.C. §§ 6343(b) and 7426. See Pet. 13-14.

The court of appeals below read this passage from *Rodgers* to "impl[y] that levy is not normally intended for use as against property in which third parties have an interest" or "as against property bearing on its face the names of third parties" (Pet. App. 17a). Contrary to the Eighth Circuit's reading, which respondent adopts (Br. in Opp. 9), the *Rodgers*' opinion contains no such implication. The *Rodgers*' Court correctly pointed out that Section 6331 does not "implicate the rights of third parties" because, as noted in our petition (at 15, 17-18, 19), an administrative levy, unlike a judicial lien-foreclosure action, does not determine ultimate ownership rights where such rights are in dispute. Rather, Congress has provided that third parties' competing claims to the property levied upon will be resolved *after* the levy is made, in a post-seizure administrative or judicial hearing. See *Rodgers*, slip op. 17, citing I.R.C. 6343(b) §§ and 7426. In *G.M. Leasing Corp.* v. *United States*, 429 U.S. 338 (1977), this Court specifically upheld the validity of an IRS levy on property bearing on its face the name of a third party — a straw man found to be the delinquent taxpayer's alter ego (see 429 U.S. at 350-351). And, as noted in our petition (at 17 n.11), the lower courts have regularly done the same. Nothing in *Rodgers* suggests that this Court would invalidate an IRS levy on a jointly-titled bank account where (as here) the taxpayer has the unrestricted right to obtain possession of the full outstanding balance at any time without notice to his co-depositors.

For these reasons and for the reasons set forth in our petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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Solicitor General

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